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In the Supreme Court of the United States

OCTOBER TERM, 1990

CONNECTICUT OFFICE OF CONSUMER COUNSEL, ET AL.,
PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT*

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the Federal Communications Commission acted arbitrarily and capriciously in finding that a gross receipts tax flow-through, which passed on to Connecticut ratepayers the costs of that State's narrowly targeted gross receipts tax on interstate telecommunications, was not unreasonably discriminatory.
2. Whether the Federal Communications Commission abused its discretion in rejecting petitioners' request for a trial-type hearing and deciding the complaint on the basis of a record that included discovery, written testimony, and briefs.

(I)



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OPINIONS BELOW

The opinion of the court of appeals is reported at 915 F.2d 75 (Pet. App. 1a-14a). The order of the Federal Communications Commission is reported at 4 FCC Rcd 8130 (Pet. App. 15a-55a).

JURISDICTION

The judgment of the court of appeals was entered on September 20, 1990. The petition for a writ of certiorari was filed on December 18, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioners filed a petition for review in the court of appeals challenging the Federal Communications Commission's (FCC's) determination that American Telephone and Telegraph Company (AT&T) could impose the costs of Connecticut's narrowly targeted telecommunications gross receipts tax directly on Connecticut ratepayers. The court of appeals denied the petition, concluding that the FCC properly prevented Connecticut from exporting the burden of that tax to out-of-state ratepayers through nationwide averaged rates. Pet. App. 1a-14a.

1. The Communications Act of 1934 (as amended), 47 U.S.C. 151 *et seq.*, places the primary responsibility for setting telephone rates on the carriers themselves, who initiate rate changes by filing tariffs with the FCC. 47 U.S.C. 203. See generally *New England Telephone & Telegraph Co. v. FCC*, 826 F.2d 1101, 1104 (D.C. Cir. 1987), cert. denied, 490 U.S. 1039 (1989). Those rates must be "just and reasonable," 47 U.S.C. 201(b), and free of "any unjust or unreasonable discrimination," 47 U.S.C. 202(a). The FCC may reject a tariff if it is unlawful on its face. See *Associated Press v. FCC*, 448 F.2d 1095, 1103 (D.C. Cir. 1971).¹ In addition, any person who is injured by a communications common carrier may file a complaint with the FCC, 47 U.S.C. 207 and 208, which has the discretion to investigate the matters complained of "in such manner and by such means as it shall deem proper." 47 U.S.C. 208. The FCC

¹ The FCC may also investigate legally suspect rates that are not patently unlawful and, pending a hearing, may suspend the effectiveness of those rates for up to five months. 47 U.S.C. 204(a). See *American Telephone & Telegraph Co. v. FCC*, 487 F.2d 865, 871 (2d Cir. 1973). If the investigation is not completed within that time, the proposed rates become effective by operation of law, but the FCC may order refunds of amounts ultimately found to be unjustified. 47 U.S.C. 204(a).

may award monetary damages to the complainant if the complainant is entitled to damages. 47 U.S.C. 209.

2. The rates for interstate long-distance telephone calls are generally determined on the basis of the long-distance company's costs of providing the telephone service.² Traditionally, long-distance companies, such as AT&T, have averaged their interstate costs over the nation to produce a system of uniform, nationwide averaged rates. Under that system, users in high cost areas pay approximately the same charges as users in low cost areas for calls having similar characteristics of distance and duration. Nationwide averaged rates generally reflect, among other things, an average of the interstate access charges assessed by the various local telephone companies and an average of the property, corporate income, and other generally applicable taxes assessed against the carrier by the various states. See Pet. App. 4a-5a.

During the mid-1980s, several States, including Connecticut, targeted telecommunications for special taxes on the carrier's gross receipts. AT&T recognized that if those gross receipts taxes were subject to the normal interstate rate averaging process, the burden they impose would be exported to residents of other States through higher averaged telecommunications rates. AT&T therefore filed tariff revisions designed to pass through these narrowly targeted taxes

² All long-distance calls require the use of both local telephone plant and long-distance facilities. A typical long-distance call begins on an individual subscriber's local loop, travels through local switches to long-distance lines, and ultimately returns to another local system where the recipient of the call resides or does business. Since the breakup of the unified Bell System, the provision of interstate long-distance service has required the interstate activities of both long-distance (or interexchange) carriers, such as AT&T, and local telephone companies, which provide the "access" that connects the long-distance facilities to local subscribers. See generally *National Ass'n of Regulatory Util. Comm'r's (NARUC) v. FCC*, 737 F.2d 1095, 1105 (D.C. Cir. 1984), cert. denied, 469 U.S. 1227 (1985).

(through a gross receipts tax surcharge) to the consumers in the States that assessed them. The FCC denied various petitions to suspend or reject those filings, and the First Circuit subsequently dismissed challenges to the FCC's action, finding that the FCC's determination not to suspend the tariff was not a final reviewable order. *Maine Public Advocate v. FCC*, 828 F.2d 68, 69 (1st Cir. 1987). Pet. App. 5a-6a.

In March 1988, petitioners Connecticut Office of Consumer Counsel, *et al.*, filed a complaint with the FCC alleging that AT&T's flow-through provision was unjust, unreasonable and unreasonably discriminatory under Sections 201(b) and 202(a) of the Communications Act. Petitioners also asserted that, even if AT&T could permissibly flow through gross receipts taxes in principle, the carrier's method of calculating the flow-through over-collected the cost of those taxes. They requested the FCC to restrain future enforcement of the flow-through provision in Connecticut and to order AT&T to refund to Connecticut ratepayers all sums collected under that provision. Petitioners also moved for an evidentiary hearing on their complaint. Pet. App. 6a-7a.

The FCC dismissed petitioners' complaint, concluding that the flow-through did not result in "unjust or unreasonable" discrimination. Pet. App. 15a-55a. The FCC acknowledged that ratepayers in States subject to the flow-through provision would pay more for AT&T long-distance service than those in States with generally applicable taxes that are pooled, but explained:

[W]ere AT&T not to flow through the gross receipts tax, states would have an incentive to target telecommunications carriers for special tax burdens and thereby export the cost of the tax [through the averaging process] to customers in other states, * * * who do not directly benefit from, and do not have the ability to

influence the imposition of, this tax. Accordingly, we find that it is neither unjust nor unreasonable to pool taxes of general applicability, along with other expenses, in determining nationwide averaged rates, but to exclude gross receipts taxes.

Id. at 37a-38a. The FCC also rejected petitioners' claim that AT&T's methodology for calculating the gross receipts tax flow-through over-collected the costs of that tax. *Id.* at 43a-44a. Finally, the FCC denied petitioners' request for an evidentiary hearing. *Id.* at 45a-48a. The agency concluded that there were no material disputed facts that would justify time-consuming and costly evidentiary hearings, noting that petitioners had been given "ample opportunity to develop evidence in this matter, including discovery," and that petitioners' factual allegations were "not germane to the outcome of this proceeding." *Id.* at 46a-47a.

3. The court of appeals denied petitioners' petition for review, finding the FCC's action to be "well within its broad authority." Pet. App. 7a, 10a. The court noted at the outset that the Communications Act "does not require equal rates for all customers. Rather, it requires only that rate differentials between customers for like service be 'just and reasonable.'" *Id.* at 10a. Nationwide rate averaging, the court reasoned, "is thus not compelled by the statute but has been adopted by the Commission as a means of ensuring that basic telecommunications services are available nationwide and will not be foreclosed in areas where fixed costs tend to be high relative to use." *Ibid.* The gross receipts tax flow-through, the court found, was a reasonable exception to this general policy, and, in fact, operated to protect the averaging process from manipulation. *Ibid.*

The court found "unassailable" the FCC's conclusion that without a gross receipts tax flow-through, "states would have an incentive to target telecommunications companies as sources of revenue, with the bulk of the tax incidence

ultimately falling on out-of-state residents through nationwide averaging.” Pet. App. 10a-11a. Indeed, the court noted, “the record suggests that the prospect of this windfall influenced Connecticut’s retention of the gross receipts tax over alternate forms of taxation.” *Id.* at 11a.³ The court distinguished gross receipts taxes from other state assessments that AT&T customarily pooled. The court noted, for instance, that “property and income taxes are broad-based, and their burdens fall for the most part on residents who are represented in the state’s political process.” *Id.* at 11a-12a. Unlike the gross receipts tax at issue here, such taxes “do not single out an industry that must average its fixed costs nation-wide by regulatory order and therefore do not offer an opportunity to transfer the burden of the tax to non-residents.” *Id.* at 12a. Thus, the court concluded, “while a pass-through mechanism is necessary in the case of a gross receipts tax, it is not needed for these other types of taxes.” *Ibid.*

The court of appeals also rejected petitioners’ claim that AT&T’s formula for calculating the flow-through over-collected the costs to AT&T attributable to the gross receipts tax. Pet. App. 13a-14a. Like the FCC, the court found that the flow-through was designed to recover no more than the actual tax costs AT&T incurred—both directly from the tax on AT&T’s revenues, exclusive of access costs, and indirectly from the “portion of access charges paid that were at-

³ The court observed that in the absence of a gross receipts tax flow-through, “the success of a few states in exporting their tax burden via interstate rates would cause other states to impose their own gross receipts taxes in response” and lead to “an upward-spiraling of interstate telephone rates to a level bearing no relation to actual costs of service.” Pet. App. 11a. “Nipping that prospect in the bud,” the court found, “is well within the Commission’s mandate ‘to make available . . . a rapid, efficient, Nation-wide . . . communication service with adequate facilities at reasonable charges.’” *Ibid.*, quoting 47 U.S.C. 151.

tributable to the tax on local exchange carriers' access charge revenues." *Id.* at 14a. With respect to the latter component of the flow-through, the court found that petitioners offered "no reason * * * to believe that the tax on local carriers' access charge revenue was not passed along to AT&T." *Ibid.*

Finally, the court rejected petitioners' assertion that the FCC erred in denying its request for an evidentiary hearing. Having previously noted that the proceeding before the agency had included discovery, written testimony and briefs, Pet. App. 7a, the court found that there "were no relevant factual issues in controversy and no need for a factual hearing." *Id.* at 14a.

ARGUMENT

The court of appeals correctly concluded that AT&T's gross receipts tax flow-through tariff was not unjustly or unreasonably discriminatory to Connecticut consumers. That ruling does not conflict with any decision of this Court or another court of appeals. Moreover, Connecticut has repealed its gross receipts tax effective January 1, 1990, and the issue thus has limited continuing significance. The court of appeals also correctly affirmed the FCC's conclusion that no pertinent issue of disputed fact existed that would require an evidentiary hearing. Petitioners' continued insistence that the agency abused its discretion in this case by deciding the case on written submissions does not merit further review.

1. Petitioners assert that the court of appeals erred in failing to reverse, as arbitrary and capricious, the FCC's ruling that AT&T's gross receipts tax flow-through did not unreasonably discriminate against Connecticut ratepayers. Pet. 21-37. In particular, petitioners complain that the court's decision "is not supported on the record and is con-

trary to significant ratepayer and consumer interests.” *Id.* at 21. As the court of appeals noted, however, the FCC has “broad discretion” in carrying out its ratemaking functions. Pet. App. 8a, citing *Permian Basin Area Rate Cases*, 390 U.S. 747, 800 (1968); *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944). Petitioners’ challenge to the court of appeals’ application of this appropriately deferential standard is not a matter warranting this Court’s further review.

In any event, the court of appeals’ conclusion that the FCC acted “well within its broad authority,” Pet. App. 10a, is correct and is consistent with recent decisions of the District of Columbia and Ninth Circuits, which have held that a “‘neutral, rational basis underlying apparently disparate charges’ * * * precludes a finding that the rates are ‘unreasonably’ discriminatory.” *American Telephone & Telegraph Co. v. FCC*, 832 F.2d 1285, 1293 (D.C. Cir. 1987), quoting *NARUC v. FCC*, 737 F.2d at 1133; accord *Reservation Telephone Coop. v. FCC*, 826 F.2d 1129, 1136 (D.C. Cir. 1987); *Air Transp. Ass’n of America v. Public Util. Comm’n*, 833 F.2d 200, 206 (9th Cir. 1987).

As we have explained, the court of appeals sustained the FCC’s action as a “reasonable exception” to its policy favoring nationwide rate averaging “because without [the flow-through], states would have an incentive to target telecommunications companies as sources of revenue, with the bulk of the tax incidence ultimately falling on out-of-state residents through nationwide averaging.” Pet. App. 10a. “The result would be an upward-spiraling of interstate telephone rates to a level bearing no relation to actual costs of service.” *Id.* at 11a. Thus, the flow-through in fact served to protect the integrity of the averaging process and the statutory goal of universal service that process was designed to promote. *Ibid.* See also *NARUC v. FCC*, 737 F.2d at 1108; *United States v. Western Elec. Co.*, 569 F. Supp. 1057,

1120 (D.D.C. 1983) (stressing importance of the public's interest in universal service). As such, the flow-through was not unreasonably discriminatory.

None of petitioners' renewed attacks on the FCC's analysis bears scrutiny. Petitioners claim, for instance, that all state taxes export tax burdens to non-residents, and thus avoiding such exportation does not provide a basis to distinguish gross receipts taxes from other state assessments. Pet. 25. As the court of appeals recognized, however, this claim misses the point of the FCC's analysis. While nationwide rate averaging exports from every State a portion of the carrier's state-specific costs of business (while importing a portion of such costs from every other State), broad-based state taxes, such as property and income taxes, "fall for the most part on residents who are represented in the state's political process." Pet. App. 11a-12a.

Gross receipts taxes, on the other hand, create a "political and financial windfall" for the taxing State by narrowly targeting industries, like telecommunications, which must average costs nationwide by regulatory order. Pet. App. 11a. Most of the burden of such taxes falls, through the averaging process, on nonresidents. Although petitioners belittle this distinction between narrow- and broad-based taxes in their petition, the record below indicates that the Connecticut legislature clearly recognized and sought to capitalize on the distinction in selecting the gross receipts tax over alternative revenue sources. *Id.* at 11a, 52a-53a n.19.⁴

⁴ Petitioners rely heavily (Pet. 26-31) on *City of Montrose v. Public Util. Comm'n*, 197 Colo. 119, 590 P.2d 502 (1979), for a different result. That case, however, simply reflects one State's construction of the requirements of its public utilities statute and would not bear directly on the lawfulness of the FCC's action under the Communications Act. In any event, the circumstances presented in *Montrose* and this case are not analogous. The regulatory order implementing the municipal franchise fee flow-through in *Montrose* had been adopted "solely as

Petitioners are also mistaken in claiming that a cost-of-service study was necessary to assess the reasonableness of AT&T's gross receipts tax flow-through. Pet. 27-32. The FCC and the court of appeals correctly found that AT&T's aggregate costs in Connecticut, relative to other States, were irrelevant to the question whether the species of cost at issue here—gross receipts taxes—should be pooled. Pet. App. 12a, 38a-41a. In fact, because rate averaging, by definition, results in above-cost rates in some States and below-cost rates in others, linking the validity of the flow-through to AT&T's relative state-by-state cost levels would be inconsistent with the rate averaging principle petitioners purport to support. *Id.* at 12a.⁵

2. Connecticut's repeal of its gross receipts tax, Pet. 19-20, has eliminated any warrant for further review of the court of appeals' decision. Injunctive relief against applica-

a matter of administrative convenience," 147 Colo. at 123, 590 P.2d at 506, and without reference to universal service concerns of the type that the FCC properly considered under the Communications Act.

⁵ Petitioners' additional contentions that no consumer groups have supported the flow-through (Pet. 24-25), and that the Connecticut tax long pre-dated the flow-through without having an adverse impact on nationwide rates (*id.* at 32-33), are of no significance. Including the costs of Connecticut's gross receipts taxes in AT&T's nationwide cost pool would, as a matter of mathematical certainty, increase nationwide averaged rates. The fact that such costs previously were distributed so widely that no consumer group found it worthwhile to challenge them is simply irrelevant to the FCC's "unassailable" analysis. Pet. App. 11a. Petitioners' suggestion that the FCC should have determined the lawfulness of Connecticut's tax, rather than approving AT&T's flow-through (Pet. 34), is plainly without merit. Section 208 of the Communications Act provides an avenue for resolving complaints against "common carriers" for actions taken "in contravention of the [Communications Act]." 47 U.S.C. 208. Whatever might be said of the lawfulness of Connecticut's gross receipts tax, that question was beyond the legitimate scope of this administrative proceeding, which properly was confined to questions regarding the lawfulness of AT&T's tariff.

tion of the flow-through in that State is clearly moot, and even if petitioners prevailed on the merits, any reparations to petitioners would likely be limited to damages the state agencies incurred in their proprietary capacities. Pet. App. 8a n.1. See, e.g., *Hawaii v. Standard Oil Co.*, 405 U.S. 251, 257-266 (1972) (denying a State standing, as *parens patriae*, to seek damages under Section 4 of the Clayton Act). Moreover, because several other States have repealed their gross receipts taxes, Pet. App. 52a-53a n.19, and the few remaining States with such taxes have chosen not to challenge AT&T's flow-through, petitioners' challenge is unlikely to bear seriously upon any broader current or future interests.

3. Petitioners' contention that the denial of their request for an evidentiary hearing "constitutes an abuse of discretion under the circumstances of [this] case" (Pet. 37) does not present an issue warranting this Court's review. First, Section 208 of the Communications Act does not mandate evidentiary hearings on complaints. Rather, it gives the FCC broad discretion to investigate complaints "in such manner and by such means as it shall deem proper." 47 U.S.C. 208. In the absence of constitutional due process concerns, which the petitioners do not assert, reviewing courts generally are not free to impose procedural rights where Congress has chosen not to require them. See *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 524 (1978).

Moreover, the FCC's established policy has been to reserve evidentiary hearings for those cases in which disputed issues of material fact make oral testimony essential to resolving the case. See Pet. App. 46a-47a. The FCC's denial of petitioners' request for an evidentiary hearing here was a straightforward application of that policy; the only facts alleged to be in controversy were "not germane to the outcome of this proceeding." *Id.* at 47a. Petitioners' continued

insistence that factual issues remained as to AT&T's cost of service in Connecticut brushes past the FCC's analysis, which approved the flow-through of one category of costs — gross receipts taxes — regardless of the relative state-by-state levels of other costs. The court of appeals properly affirmed that analysis and correctly concluded that the FCC did not abuse its discretion in declining to hold an evidentiary hearing. *Id.* at 39a-40a.⁶

CONCLUSION

The petition for a writ of certiorari should be denied.
Respectfully submitted.

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⁶ Petitioners' suggestion (Pet. 18, 38) that a trial-type hearing was required to determine whether AT&T correctly calculated the flow-through is incorrect. Petitioners' principal challenge to AT&T's calculations was methodological, see Pet. App. 14a, making it well suited to resolution on the basis of written submissions. And as the court of appeals found, despite discovery, written testimony and briefs, the State otherwise offered "no reason" to believe that AT&T's flow-through calculations contained any errors. *Ibid.*